Ceramic Protection CORPORATION

2001 Annual Report

Ceramic Protection
CORPORATION

Annual Report Contents

The Corporate Technical Achievement Award to the Corporation was in recognition of "Commercialization of Technology for High Alumina Armour Ceramic Tiles for Ballistic Protection."

LETTER TO SHAREHOLDERS

Executive Summary

The fiscal year ended October 31, 2001 was disappointing due to a significant reduction in revenue. However the Corporation entered new markets with improved product lines such as completed personnel armour plates and vehicular armour systems.

In April 2001, the Corporation was formally presented with the prestigious Corporate Technical Achievement Award by the American Ceramic Society at the annual meeting of the society in Indianapolis, Indiana. Mr. Robert Oxnard, President of the Society, made the presentation to Dr. Ron Wallace and Dr. Eugene Medvedovski on behalf of the Corporation, along with invited guests from the Alberta Research Council and General Motors Defense. This was the first occasion in the 104 year history of this distinguished Society that the Award was presented to a company located outside the United States.

The Corporation reached an important milestone when it completed its research and development program in conjunction with the National Research Council of Canada. The development and testing of armoured panels for use in non-military applications with the participation of a US based vehicle manufacturer holds promise for future sales of integrated armour systems.

Ceramic Protection CORPORATION

Our Products

Ceramic Protection Corporation is a unique Canadian manufacturer of products for resource industries and the defense sectors.

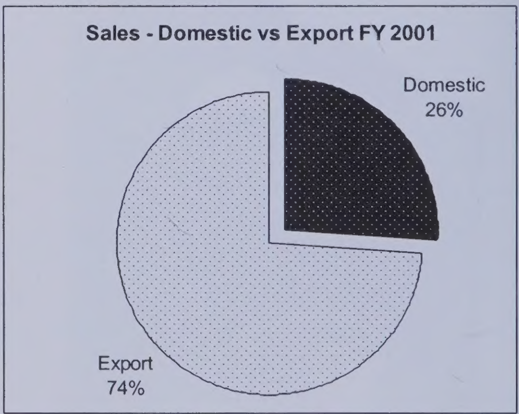
The Corporation is an established, capable manufacturer of ceramic and composite products used in wear management applications for a variety of industries, including mining, chemical and oil and gas production.

The Corporation has also attained an international reputation for its ballistic protective ceramic materials and composite systems used in personnel and vehicular armour systems.

In the category of wear management applications, many customers in several industries continue to appreciate the commercial applications for industrial ceramic products. These materials have been found to significantly reduce the lifetime service and maintenance costs of industrial equipment. Industrial ceramics are resistant to, and exhibit superior performance for, factors such as thermal shock, corrosion and abrasion. New ceramic applications developed by the Corporation for major industrial manufacturers have demonstrated significant successes.

The Corporation continues to seek out alliance and specialist manufacturing opportunities for its ceramics. In 2001, a major international chemical manufacturer requested that the Corporation develop and manufacture large high temperature cyclones. These, and related applications, offer promise for future industrial product introductions.

The Corporation continues to enhance its ballistic systems. In co-operation with the Alberta Research Council the Corporation has systematically improved its high-tolerance ballistic ceramic tile capabilities. In addition, the successful introduction of completed personnel armour plates to clients world-wide has allowed the Corporation to maintain its global market presence as a recognized center of manufacturing excellence. These world-class products have allowed the Corporation to provide military and police clients worldwide with superior materials which have been demonstrated to perform to exceptional standards.



The Corporation continued to increase its export sales to an expanding client base outside of Canada. The Corporation increased its total export sales from 69% of gross sales in 2000 to 74% in 2001. The Corporation will continue to press for an expanded international client base while enhancing its commercial and technical competitive strengths.

Ceramic Protection CORPORATION

The Year in Review

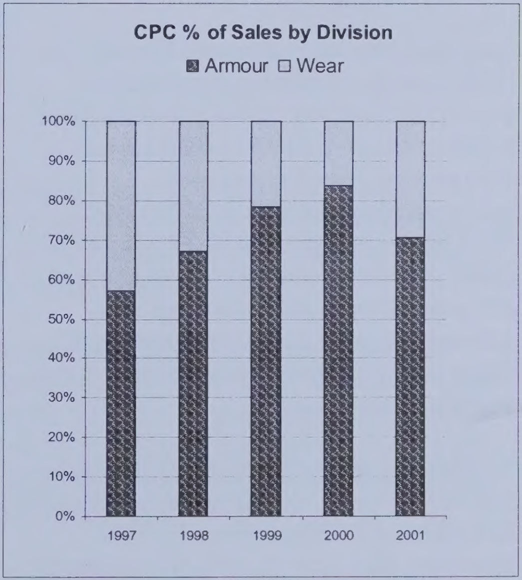
The year ended October 31, 2001 was difficult for the Corporation as many external market conditions combined to reduce, or delay, sales.

The Corporation completed deliveries of ballistic ceramic tiles for 13 Armoured Personnel Carriers and completed several personnel armour plate orders for international clients, primarily those based in the UK.

Reduced availability of aramid materials used in the manufacture of personnel vests and vehicular armour systems significantly impacted sales for ballistic protective products world-wide. The Corporation was subject to the difficulties caused by these supply interruptions and the subsequent fall-off in orders from major integrated producers. In addition, the rationalization in the international armour supplier marketplace continued with several major integrated manufacturing houses closing during the year. These impacts on the Corporation were mitigated, in part, by our diversification as a primary supplier to a wider range of clients, particularly in the United States.

At the same time, demand for wear management materials for industrial sectors, such as mining, slowed during the year. The effects of the economic slowdown resulted in reduced demand for base metals as well as longer maintenance cycles at the mills and mines of major clients.

Wear management sales declined slightly year to year but increased, relative to armour sales, from approximately 16% of total sales in 2000 to 29% in 2001. Nonetheless, the Corporation pursued continued research and development activity undertaken in conjunction with major federal and provincial agencies. These initiatives to develop new ceramic products for ballistic and wear management applications have the potential to bring the Corporation into new manufacturing markets in the foreseeable future.



Year-to-year sales of wear management materials fell 3.5% from $923,000 in 2000 to $891,000 in 2001. This slight decline reflected a slowing in the growth of industrial producers, particularly mining operations, throughout North America.

Armour product sales fell by 55.3 % from $4,747,000 in 2000 to $2,123,000 in 2001. The extreme circumstances resulting from the decrease in available aramid materials and unavoidable external delays in startups of potential vehicular armour contracts accounted for the unexpected and significant decline in sales.

Ceramic Protection CORPORATION

Notwithstanding these challenges, the Corporation's ongoing R&D program is addressing new and future opportunities on a broad scale with several major manufacturers and several leaders in the defense industry, both in Canada and internationally.

Total sales for the year ended October 31, 2001 were $3,014,000 as compared to $5,671,000 in 2000. Gross profit declined to $468,000 from $1,815,000 achieved in the previous year. General and administrative expenses in 2001 were $918,000 as compared with $1,036,000 in 2000, reflecting reduced costs in line with the reduced sales activities. This was achieved through the implementation of better administrative management and cost tracking procedures.

The net loss for the year was $1,012,000 or $ 0.149 per share, as compared to a profit of $19,000 or $ 0.003 per share in 2000. Operating cash flow in 2001 was negative $624,000 as compared to positive $547,000 in 2000.

Outlook

Subsequent to the year ended October 31, 2001, the Corporation was invited to bid on several significant armour contracts. In February 2002 the Corporation was awarded a contract from the Canadian Military for ballistic ceramic body armour. This contract was in the amount of $800,000 and commenced in March 2002. This contract will have a significant positive impact on the second quarter.

Ceramic Protection Corporation has continued to make significant progress in manufacturing, marketing and product development activities. The progress made in the development of new armour module systems for domestic and military applications, new specialized personnel armour offerings and the strengthening of sales in wear management applications contribute to our confident view of strengthened sales in the coming year.

The Corporation has implemented better cost management practices and has enhanced efficiencies in production for military and industrial products. The Corporation is endeavouring, with the active support of major R&D agencies in Canada, and with the prospect of significant manufacturing opportunities with major original equipment manufacturers, to broaden product offerings and to stabilize manufactured production now and in the immediate future. The award-winning team at Ceramic Protection Corporation has demonstrated its commitment to excellence and an ability to achieve world-class production of advanced materials.

Respectfully submitted,

Ron R. Wallace, PhD.
Chief Executive Officer
Board Member.

Ceramic Protection CORPORATION

PRICEWATERHOUSECOOPERS

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Auditors' Report

To the Shareholder of
Ceramic Protection Corporation

We have audited the balance sheets of **Ceramic Protection Corporation** as at October 31, 2001 and 2000 and the statements of earnings and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at October 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Calgary, Alberta

Ceramic Protection Corporation

Balance Sheets
As at October 31, 2001 and 2000

	2001 $	2000 $
Assets		
Current assets		
Cash	-	60,745
Accounts receivable	685,247	1,109,360
Inventory (note 3)	575,234	767,001
Prepaid expenses, supplies and deposits	43,475	47,031
Other current assets	105,084	-
	1,409,040	1,984,137
Capital assets (note 4)	3,951,794	4,302,255
	5,360,834	6,286,392
Liabilities		
Current liabilities		
Bank indebtedness (note 5)	156,244	-
Accounts payable and accrued liabilities	596,615	524,880
Current portion of long-term debt (note 6)	223,199	148,407
	976,058	673,287
Long-term debt (note 6)	1,639,595	1,856,548
	2,615,653	2,529,835
Shareholders' Equity		
Share capital (note 7)	5,399,014	5,398,114
Deficit	(2,653,833)	(1,641,557)
	2,745,181	3,756,557
	5,360,834	6,286,392

Approved by the Board of Directors

Larry Moeller, Director

Ron Wallace, Director

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CORPORATION

Statements of Earnings and Deficit
For the years ended October 31, 2001 and 2000

	2001 $	2000 $
Sales	3,014,021	5,670,646
Cost of sales	2,545,608	3,855,272
	468,413	1,815,374
Operating expenses		
General and administrative	917,953	1,036,146
Interest on long-term debt	153,796	163,887
Other income	(8,660)	(15,872)
Research and development	29,621	84,131
Depreciation	387,979	527,727
	1,480,689	1,796,019
Net income (loss) for the year	(1,012,276)	19,355
Deficit - Beginning of year	(1,641,557)	(1,660,912)
Deficit - End of year	(2,653,833)	(1,641,557)
Earnings (loss) per common share – Basic and diluted	(0.149)	0.003

Ceramic Protection
CORPORATION

Statements of Cash Flows
For the years ended October 31, 2001 and 2000

	2001 $	2000 $
Cash provided by (used in)		
Operating activities		
Net income (loss)	(1,012,276)	19,355
Item not affecting cash		
Depreciation	387,979	527,727
	(624,297)	547,082
Net change in non-cash working capital items	586,087	40,521
	(38,210)	587,603
Investing activities		
Purchase of capital assets	(37,518)	(73,901)
Financing activities		
Decrease in long-term debt	(142,161)	(124,421)
Issue of share capital, net	900	421,730
	(141,261)	297,309
Increase in cash (bank indebtedness)	(216,989)	811,011
Cash (bank indebtedness) – Beginning of year	60,745	(750,266)
Cash (bank indebtedness) – End of year	(156,244)	60,745
Supplemental information		
Cash paid for		
Interest	160,401	182,080
Income taxes	-	-

Ceramic Protection Corporation

Notes to the Financial Statements
October 31, 2001 and 2000

1) Summary of significant accounting policies

Revenue

For sales contracts with terms less than three months, revenue is recognized upon shipment of goods. Sales contracts extending beyond three months are recognized using the percentage-of-completion method.

Inventories

Raw materials are stated at lower of cost and replacement value. Cost is determined on a first-in, first-out basis.

Work-in-progress and finished goods are stated at the lower of cost and net realizable value, with cost being determined on a moving average basis.

Capital assets and depreciation

Capital assets are recorded at cost and amortized on a straight-line basis over their estimated useful lives as follows:

Building	25 years
Kiln and pattern equipment	10 years
Tile press	20 years
Other equipment	5 years
Technology license	10 years
Kiln furniture	18 months

In the year of acquisition, the company records one-half of the annual depreciation charge.

Earnings (loss) per common share

Earnings (loss) per common share is calculated using the weighted average number of common shares outstanding during the year. Diluted earnings per share are calculated using the treasury stock method for determining the dilutive effect of options.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using enacted income tax rates. The effect of a change in income tax rates on future income tax liabilities and assets is recognized in income in the period that the change occurs.

Notes to the Financial Statements
October 31, 2001 and 2000

Stock-option plan

The Company has a stock option plan enabling certain officers, directors and employees to purchase common shares at exercise prices equal to the market price on the date the option is granted. No compensation expense is recognized for this plan when the stock options are issued. Any consideration paid to the Company on exercise of stock options is credited to share capital. If stock or stock options are repurchased, the excess of the consideration paid over the carrying amount of the stock or stock options cancelled is charged to retained earnings.

2) Changes in accounting policies

Earnings per share

The Company retroactively adopted the new Canadian Institute of Chartered Accountants earnings per share standard in 2001. Under the new standard, the treasury stock method is used instead of the imputed earnings method to determine the dilutive effect of stock options and other dilutive instruments. There was no effect on the prior diluted earnings per share for 2001.

Income taxes

The Company adopted the asset/liability method of accounting for future income taxes in 2000, whereby future income taxes liabilities are determined by applying the tax rate at the end of the fiscal year to temporary differences between the accounting and tax bases of the assets and liabilities of the company. The future income tax asset or liability results from differences between the tax base and carrying values of capital assets, share issuance costs and research and development costs. While retroactive application is required, the Company's opening retained earnings remains unchanged as the retroactive application would not result in a change from opening retained earnings as stated. There was no effect on 2000 earnings.

3) Inventory

Inventories consist of:

	2001 $	2000 $
Raw materials	225,595	236,417
Work-in-progress	120,906	191,857
Finished goods	228,733	338,727
	575,234	767,001

Notes to the Financial Statements
October 31, 2001 and 2000

4) Capital assets

Capital assets consist of the following:

			2001
	Cost $	**Accumulated amortization** $	**Net** $
Land	519,480	-	519,480
Building	2,480,174	514,252	1,965,922
Kiln and pattern equipment	1,756,316	1,130,017	626,299
Tile press	981,768	211,803	769,965
Other equipment	654,774	609,719	45,055
Technology licence	57,582	46,260	11,322
Kiln furniture	279,651	265,900	13,751
	6,729,745	2,777,951	3,951,794

			2000
	Cost $	**Accumulated amortization** $	**Net** $
Land	519,480	-	519,480
Building	2,474,775	415,205	2,059,570
Kiln and pattern equipment	1,747,013	953,656	793,357
Tile press	979,488	166,002	813,486
Other equipment	650,818	556,773	94,045
Technology licence	57,582	40,512	17,070
Kiln furniture	263,071	257,824	5,247
	6,692,227	2,389,972	4,302,255

5) Bank indebtedness

The Company has a bank facility available up to the lesser of $750,000 and 75% of accounts receivable.
The bank operating line bears interest at prime plus 1½% (2000 – ¾%) per annum and is secured together with long-term debt (see note 6)).

Notes to the Financial Statements
October 31, 2001 and 2000

6) Long-term debt

	2001 $	2000 $
Mortgage loan #1, repayable in monthly instalments of principal of $11,920 plus interest at prime (October 31, 2001 – 6.36%; October 31, 2000 – 7.0%) plus 1.5% on the outstanding balance to September 1, 2011	1,404,101	1,503,770
Mortgage loan #2, repayable in monthly instalments of principal of $3,541 plus interest at prime (October 31, 2001 – 6.36% ; October 31, 2000 – 7.0%) plus 1.5% on the outstanding balance, to September 1, 2011	421,027	463,519
Other loan	37,666	37,666
	1,862,794	2,004,955
Less: Current portion	223,199	148,407
	1,639,595	1,856,548

Mortgage loans #1 and #2 and the operating line of credit are secured by a first fixed charge against the building, assignment of insurance, and a general security agreement.

Principal repayments over the next five years are as follows:

	$
2002	223,199
2003	185,532
2004	185,532
2005	185,532
2006	185,532
Thereafter	897,467
	1,862,794

Notes to the Financial Statements
October 31, 2001 and 2000

7) Share capital

Authorized

The Company is authorized to issue an unlimited number of common shares.

Issued

The Company has issued and has outstanding the following common shares.

	2001		2000	
	Number of shares	Amount $	Number of shares	Amount $
Balance – Beginning of year	6,773,068	5,398,114	5,530,600	4,976,384
Options exercised	2,000	900	-	-
Issued for cash, net	-	-	1,242,468	421,730
Balance – end of year	6,775,068	5,399,014	6,773,068	5,398,114

Stock based compensation plans

Pursuant to the terms of a stock option plan established in 1995, options may be granted to certain officers, directors and employees to purchase common shares of the company. Options are exercisable at one third six months following the grant date with one-third exercisable each year after that. The options expire five years after the grant date.

A summary of the Company's stock option plan as of October 31, 2001 and October 31, 2000, and changes during the years ended on those dates is presented below.

	2001		2000	
	Shares	Weighted average exercise price $	Shares	Weighted average exercise price $
Outstanding – Beginning of year	489,000	0.45	462,500	1.60
Exercised	(2,000)	0.45	-	-
Granted	81,500	0.45	489,000	0.45
Cancelled	(19,000)	0.45	(462,500)	1.60
Outstanding – End of year	549,500	0.45	489,000	0.45
Options exercisable – End of year	339,167	0.45	163,000	0.45

Notes to the Financial Statements
October 31, 2001 and 2000

There were 549,500 options outstanding at October 31, 2001, all with an exercise price of $0.45 and a weighted average remaining contractual life of 3.54 years.

At October 31, 2000, there were 489,000 options outstanding all with an exercise price of $0.45 and a weighted average remaining contractual life of 4.45 years.

Warrants

During the year ended October 31, 1999, the Company issued 200,000 warrants as part of a joint research venture to its co-venturer. Each warrant is exercisable for one common share at a price of $2.00. The warrants expire in June 2002.

8) Income taxes

The Company's provision for income taxes differs from the result that would be obtained by applying the combined Canadian Federal and Provincial statutory income tax rate of 43.45% (2000 – 44.62%) to income before income taxes. This difference results from the following:

	2001 $	2000 $
Computed expected expense (recovery) for income taxes	(439,709)	8,636
Increase resulting from		
Non-deductible expenses	2,996	3,748
Non-recognition (recognition) of tax benefits	436,713	(12,384)
Income tax expense	-	-

The Company has $3,805,138 (2000 – $2,943,126) of loss carryforwards and tax pools in excess of book value for which no benefit has been recognized in these financial statements as presented below:

	2001 $	2000 $
Tax benefits from		
Tax pools in excess of (less than) net book value	125,455	(43,110)
Loss carryforwards	1,527,877	1,356,332
Less: Reserve for non-recognition	(1,653,332)	(1,313,222)
	-	-

Notes to the Financial Statements
October 31, 2001 and 2000

The Company's loss carryforwards expires as follows:

	$
2002	-
2003	529,000
2004	962,000
2005	-
2006	1,292,000
2007	114,000
2008	620,000

9) Economic dependence

During the year the Company had sales to four customers which represented 53% of total sales. In 2000, three of those customers represented 70% of total sales.

10) Financial instruments

The Company's financial instruments consist of accounts receivable, bank indebtedness, accounts payable and accrued liabilities, and long-term debt.

Credit risk

Approximately 70% of the Company's sales occur outside of Canada. All significant international armour sales are insured.

Currency risk

Approximately 70% of the Company's sales occur outside of Canada and these sales are denominated in foreign currencies. The Company also purchases raw materials outside Canada and these purchases are repayable in foreign currencies.

Fair value

The carrying value of the Company's financial assets and liabilities approximate their fair value at October 31, 2001.

Ceramic Protection
CORPORATION

Corporate Information

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Directors	**Larry G. Moeller** (Chairman) Vice President, Finance Edco Financial Holdings Ltd. **Vincent S. Krynski** President Krynski Holdings Ltd. **Ron R. Wallace** Chief Executive Officer Ceramic Protection Corporation **Milt Pahl** President and CEO Native Venture Capital Co. Ltd.
Legal Counsel	**Gowling LaFleur Henderson LLP** Calgary, Alberta
Auditor	**PricewaterhouseCoopers** Calgary, Alberta
Registrar and Transfer Agent	**Valiant Trust Company** Calgary, Alberta
Stock Exchange Listing	**Canadian Venture Exchange** Trading Symbol: **CEP**

Ceramic Protection
CORPORATION

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